No. 14,549

IN THE

United States Court of Appeals

For the Ninth Circuit

SPENCER GRANT, Executor of the Last Will and Testament of BLANCHE KELLEHER GRANT, Deceased,

Appellant and Appellee,

vs.

JAMES G. SMYTH, Former Collector of Internal Revenue,

Appellee and Appellant.

On Appeals from the Judgment of the United States District Court for the Northern District of California.

REPLY BRIEF FOR THE COLLECTOR.

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Table of Authorities Cited

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While we do not deem it necessary to reply to all the arguments made in the Closing Brief for Spencer Grant, it may clarify our position if we answer some of the arguments.

1. On page 2 there are statements that Mrs. Grant's purchase of the annuity contracts in 1938 and 1939 "resulted in completed lifetime or *inter vivos* transfers in those years," and "no testamentary

transfer is involved in this case." When a similar argument was made to this Court in a similar case, *Commissioner v. Clise,* 122 F. 2d 998, certiorari denied, 315 U.S. 821, cited in our principal brief, this Court decided that the death of the first annuitant was the generating event, and caused a shifting, or the completion of a shifting of an economic benefit of property, which would justify the imposition of the estate tax. In that case this Court said (pp. 1003, 1004):

> It is argued, however, that upon her death nothing passed from the dead to the living, that the making of the annuity contracts constituted completed gifts to the second annuitants as of the dates thereof. But this assertion is to no purpose, for, so long as Mrs. Clise lived, it was impossible for the second annuitants to possess or enjoy the economic benefits of the transfer and until Mrs. Clise's death it was not an absolute certainty that any one of the second annuitants would survive her. The death of the first annuitant, then, was the generating event. *Tyler v. United States, supra.* The death of Mrs. Clise caused a shifting, or the completion of a shifting of an economic benefit of property, which is the subject of a death tax. *Chase Nat. Bank v. United States,* 278 U.S. 327, 338, * * * . We quote from *Klein v. United States,* 283 U.S. 231, 234 * * *: "It is perfectly plain that the death of the grantor was the indispensable and intended event which brought the larger estate into being for the grantee and effected its transmission from the dead to the living, thus satisfying the terms of the taxing act and justifying the tax imposed."
>
> *   *   *   *   *   *   *

> The practical effect of the annuity contracts was to reserve to Mrs. Clise the enjoyment of the property transferred and to postpone the fruition of the economic benefits thereof to the second annuitants until her death. In the light of the *Hallock* case the transfers were "too much akin to testamentary dispositions not to be subjected to the same excise." * * *

The decision of this Court in *Commissioner v. Clise, supra,* conclusively establishes that the purchase of the survivorship annuities by the decedent in this case was testamentary in character. In this connection the Closing Brief for Spencer Grant makes this important concession (p. 2):

> Of course, if we were dealing with a transfer testamentary in character, there might be merit in defendant's contention that single life contracts are comparable for valuation purposes.

2. On page 8 of the Closing Brief for Spencer Grant, counsel asserts that the Collector has made no defense to the argument that only survivorship contracts are comparable to the annuity contracts in the present case. In reply, we point out that most of Point II, pages 16 to 28, of the Collector's principal brief, is devoted to showing that only single life contracts are comparable to the contract rights which passed to Mr. Grant by virtue of Mrs. Grant's death. Upon the death of Mrs. Grant, Mr. Grant alone became entitled to receive annuities aggregating $20,744.52 annually for the rest of his life; the survivorship element was eliminated at that time. Therefore

survivorship contracts are not comparable to what Mr. Grant received upon his wife's death. In fact, Mr. Grant concedes at page 2 of his Closing Brief that if the original purchase of the annuity contracts by Mrs. Grant was testamentary in character, there might be merit in the Collector's contention that single life contracts are comparable for valuation purposes.

Furthermore, letters from seven of the eight insurance companies which issued the original contracts showed that they would not have issued survivorship contracts to Mrs. Grant on the date of her death due to the critical state of her health. (R. 126, 128, 130, 132, 134, 136, 141.) The letter from the remaining company stated that Mrs. Grant would have to pass a satisfactory medical examination in order to have such a contract issued. (R. 138.) The clear inference from these letters is that the only type of annuity contracts the insurance companies would have issued with respect to Mr. and Mrs. Grant on March 2, 1947, the date of decedent's death, were single life contracts based upon the life of Mr. Grant. From this undisputed fact it would seem to follow that only single life annuities are comparable contracts within the meaning of Treasury Regulations 105, Section 81.10 (i)(2). *Mearkle's Estate v. Commissioner*, 129 F. 2d 386 (C.A. 3d), cited at pages 18-19 of the Collector's principal brief, appears to be directly in point on that proposition.

In addition, as shown by the actuarial certificate accompanying the estate tax return in the present

case, the estate computed the value of the annuity contracts on the basis of single life annuities (R. 100-104), and the District Court approved this valuation (R. 47). The estate and the District Court, however, used a Table A formula for computing the single life annuities, which is clearly contrary to the Treasury Regulations and to *Mearkle's Estate v. Commissioner, supra,* which prescribe replacement cost as the proper measure of value. Compare *Guggenheim v. Rasquin,* 312 U.S. 254, and *United States v. Ryerson,* 312 U.S. 260, holding that for gift tax purposes the valuation of life insurance policies should be based upon replacement cost. Since the federal gift and estate taxes are construed *in pari materia* (*Harris v. Commissioner,* 340 U.S. 106, 107), it would seem to follow that for estate tax purposes replacement cost is the proper measure for valuing annuities. The Third Circuit so held in *Mearkle's Estate v. Commissioner, supra.*

On page 8 of the Closing Brief for Spencer Grant, counsel states "we find it significant that the Commissioner did not appeal in either *Higgs* or *Twogood.*"* The fact of the matter is that the taxpayer appealed from the decision of the Tax Court in *Higgs,* and the Commissioner appealed in *Twogood,* but the appeals did not involve the question of the proper valuation of the annuity in the estate of the first annuitant. Since the Third Circuit in the *Higgs* case and the

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**Estate of Higgs v. Commissioner,* 12 T.C. 280, reversed, 184 F. 2d 427 (C.A. 3d), and *Estate of Twogood v. Commissioner,* 15 T.C. 989, affirmed, 194 F. 2d 627 (C.A. 2d).

Second Circuit in the *Twogood* case decided that the annuity contracts were not testamentary transfers because the second annuitant's rights had their source in the exercise of an option by the decedent and not in a transfer by the decedent, it was not necessary for either court to pass upon the valuation question. The *Higgs* and *Twogood* cases differ from the present case, as pointed out in the Collector's principal brief, because in the first of those cases the employer of the decedent paid the entire cost of the annuity, and in the second the employer paid most of the cost. The Tax Court did not explain in either case how it valued the annuity contracts or the reasons therefor; since the question of valuation was subordinate to the question of whether there was a transfer, the Commissioner apparently did not consider it necessary to appeal the valuation question. On the other hand, there is no indication that the Commissioner took the view that the valuation question was correctly decided in those cases. His position in the present case clearly shows that in this situation he considered the contracts comparable to single life contracts rather than survivorship contracts.

3. On page 19 of the Closing Brief for Spencer Grant counsel states that the Commissioner regularly uses the Table A formula (Section 81.10(i) of Treasury Regulations 105) to value every annuity contract (including annuity contracts issued by charitable organizations), except one issued by an insurance company. The fact is that the Commissioner insists upon the use of replacement cost in valuing charitable gifts

subject to an annuity. See *Gillespie v. Commissioner,* 128 F. 2d 140, decided by this Court; *Raymond v. Commissioner,* 114 F. 2d 140 (C.A. 7th), certiorari denied, 311 U.S. 710. However, in the case of a gift to a private individual subject to an annuity, the Commissioner would use the Table A formula, or (if the transfer was made after 1951) the Table I formula. See T.D. 5906 (estate tax), 1952-1 Cum. Bull. 155, and T.D. 5902 (gift tax), 1952-1 Cum. Bull. 167. In the present case all of the annuity contracts having been issued by insurance companies (R. 38, 55-57, 64-99), there was no occasion to use the Table A formula.

4. On page 22 of the Closing Brief for Spencer Grant there appears the statement that "There is not one iota of support in the record for any notion that the $160,399 valuation is 'based on single life annuities.'" As shown at pages 20-22 of our main brief, the actuarial certificate clearly shows that the computation of $160,399.45 is based on a single life, namely, that of Spencer Grant. While the certificate of the actuaries shows that five of the six factors used differ from the factor appearing in Table A for age 67, the differences are due to the different dates for the first payment, as explained at page 22 of the principal brief for the Collector. There is no room for doubt that the $160,399.45 valuation is based on single life annuities.

CONCLUSION.

The District Court correctly decided that the annuity contracts should be included in the decedent's gross estate; but it erred in deciding that the value of the annuities should be based upon a computation for single life annuities under Table A of the Treasury Regulations. Since single life annuities are comparable contracts to the property that passed to Mr. Grant at the death of Mrs. Grant, the value should be based upon the replacement cost of single life annuities, which has been stipulated to be $257,117.20.

Respectfully submitted,

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